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HOUSE OF REPRESENTATIVES
REPORT
99-34

# REPEAL OF THE CONTEMPORANEOUS RECORDKEEPING REQUIREMENTS

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APRIL 2, 1985.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. ROSTENKOWSKI, from the Committee on Ways and Means, submitted the following

# REPORT

[To accompany H.R. 1869]

The Committee on Ways and Means, to whom was referred the bill (H.R. 1869) to repeal the contemporaneous recordkeeping requirements added by the Tax Reform Act of 1984, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

## I. EXPLANATION OF THE BILL

### A. PRESENT LAW

*Substantiation rules*

*Background*

A taxpayer may deduct expenditures, including depreciation and operating costs, attributable to business use of an automobile or other means of transportation. No deduction is allowed for expenditures attributable to the personal use of an automobile or other property (other than for interest on purchase indebtedness or for certain State taxes). For example, the costs of commuting to and from work are personal expenses that are nondeductible pursuant to Code section 262.[1]

Under general tax law principles, the courts have held that a taxpayer bears the burden of proving both the eligibility of an expenditure as a deduction or credit and also the amount of any such

[1] *Fausner* v. *Commissioner*, 413 U.S. 838 (1973).

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eligible expenditure, including the expenses of using a car in the taxpayer's trade or business.[2]

In the Revenue Act of 1962, the Congress enacted Code section 274(d), under which a taxpayer must substantiate the business purpose, amount, and date of certain types of expenditures "by adequate records or by sufficient evidence corroborating his own statement." This provision was added because the Congress recognized that "in many instances, deductions are obtained by disguising personal expenses as business expenses." [3] These specific substantiation rules were made applicable to (1) traveling expenses (including meals and lodging while away from home); (2) expenditures with respect to entertainment, amusement, or recreation activities or facilities; and (3) business gifts. Local travel expenses were not subject to this provision as enacted, but instead were subject to the general substantiation requirements applicable to all other business expenditures.

*1984 Act amendments*

*Recordkeeping.*—The Tax Reform Act of 1984 (P.L. 98-369) made several amendments to Code section 274(d), effective for taxable years beginning after December 31, 1984. First, the 1984 Act added a requirement that the taxpayer must keep "contemporaneous" records to substantiate deductions for expenditures subject to sectioin 274(d). Second, the 1984 Act deleted from section 274(d) the alternative method of substantiating deductions, which was by means of sufficient evidence, (written or oral) corroborating the taxpayer's own statement. Third, the 1984 Act made additional property subject to the requirements of section 274(d), including automobiles and other means of transportation. As a result, local travel expenses, like traveling expenses away from home, became subject to the section 274(d) rules.

*Tax preparer rules.*—The 1984 Act required that paid income tax return preparers must advise the taxpayer of the section 274(d) substantiation requirements and obtain written confirmation from the taxpayer that these requirements were met. Failure to advise the taxpayer or to obtain the confirmation subjects the return preparer to a penalty of $25 for each failure, unless due to reasonable cause and not to willful neglect (sec. 6695(b)).

*Special negligence penalty.*—The 1984 Act provided that, for purposes of the section 6653 negligence penalty, any portion of an underpayment of tax due to a failure to comply with the section 274(d) recordkeeping requirements is treated as due to negligence, in the absence of clear and convincing evidence to the contrary. The penalty is five percent of the portion of the understatement attributable to the failure to comply with the section 274(d) recordkeeping requirements (sec. 6653(h)).

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[2] See, e.g., *Interstate Transit Lines* v. *Comm'r* 319 U.S. 59, 593 (1943); *Comm'r* v. *Heininger*, 320 U.S. 467 (1943); *Gaines* v. *Comm'r*, 35 T.C.M. 1415 (1976).

[3] H. Rep. No. 87-1447 (March 16, 1962), at 19.

*Limitations on ITC and depreciation for certain automobiles*

*General rules*

In general, a 6-percent investment tax credit may be claimed for an eligible automobile, and its cost (reduced by one-half the amount of the 6-percent credit) may be recovered over three years. The accelerated recovery percentages, beginning with the first year, are 25, 38, and 37 percent. Other options with respect to the investment credit and depreciation are generally available.

However, limits generally are imposed on the amount of investment credit and annual depreciation deductions that are allowed for an automobile placed in service or leased by the taxpayer after June 18, 1984 (sec. 280F).[4] For an automobile subject to these limits and placed in service in 1984, (1) the investment tax credit is limited to $1,000, (2) depreciation in the first year is limited to $4,000, and (3) depreciation in any subsequent year is limited to $6,000.

For more expensive automobiles, the limits generally produce a recovery period longer than three years. If the depreciation limits result in unrecovered basis existing at the end of the recovery period otherwise applicable, then that basis may be recovered through a depreciation deduction in subsequent years equal to the lesser of the unrecovered basis of $6,000, if use of the automobile in those years is such that a depreciation deduction is otherwise allowable. The "unrecovered basis" means the excess of unadjusted basis over the aggregate amount of depreciation deductions that would have been allowed if 100 percent of the automobile's use had been in a trade or business or for the production of income.

The limits for any year are reduced by the proportion of total use in that year that is personal use.

*Inflation adjustment to limits*

For years after 1984, the $1,000, $4,000, and $6,000 limits are adjusted for inflation, as measured by the percentage growth of the automobile component of the Consumer Price Index for All Urban Consumers between October of the preceding year and October, 1983. The adjustment is rounded to the nearest $100. The adjusted limits for any year apply only to automobiles placed in service in that year.

B. REASONS FOR CHANGE

The contemporaneous recordkeeping requirement and related compliance provisions enacted in the Tax Reform Act of 1984 reflected concerns of the Congress about significant overstatements of deductions and credits for claimed business use of automobiles and other types of property that typically are used for personal pur-

[4] However, the limits do not apply to (1) certain automobiles acquired under binding contracts in effect before June 19, 1984; (2) ambulances and hearses used directly in the taxpayer's trade or business; (3) vehicles (such as taxicabs and limousines) used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire; and (4) regulations, trucks or vans.

Also, the limits do not apply to an automobile leased or held for leasing by a person regularly engaged in the business of leasing automobiles. Rather, the limitation affects the lessee, whose deductions for lease payments are reduced (according to tables prescribed by the Treasury) by amounts intended to approximate the results of placing the limits on the lessor.

poses, such as for commuting, vacation trips, personal errands and shopping excursions, etc. Many taxpayers who did make business use of automobiles or other vehicles failed to keep fully accurate records or based exaggerated claims of business use on inexact recollections at the time of filing their returns, To achieve increased compliance and accuracy, the Congress required that only contemporaneous records could be used to substantiate traveling expenses and the other types of expenditures listed in section 274(d), as revised by the Act. No definition of "contemporaneous" was set forth in the statute.

As businesses and individuals have sought to understand and comply with the contemporaneous recordkeeping requirement, it has become clear that the requirement sweeps too broadly and generally imposes excessive recordkeeping burdens on may taxpayers. While the Internal Revenue Service has modified its initial regulations and scheduled public hearings prior to adoption of final rules, the committee has concluded that the only appropriate actions that will provide a speedy and certain resolution to these problems are to repeal the "contemporaneous" requirement (and the tax return preparer and negligence penalty provisions) as added by the 1984 Act, to repeal the IRS temporary regulations interpreting the "contemporaneous" requirement, to reinstate with modifications generally the prior-law substantiation rules under section 274(d), and to except from these reinstated rules vehicles which, by reason of their nature, are not likely to be used more than a de minimis amount for personal purposes.

To provide guidance to taxpayers, the bill requires the IRS to issue regulations not later than October 1, 1985, carrying out the provisions of the bill. The bill specifies that these IRS regulations must fully reflect all the amendments made by the bill. In addition, IRS regulations must be consistent with the legislative history of the bill, including this report. Accordingly, any type of vehicle (such as farm tractors or combines, marked police or fire vehicles, etc.) that this report specifies are vehicles excepted from section 274(d) as qualified nonpersonal use vehicles must be so treated in the regulations.

The committee remains concerned about overstated claims of the extent of business use of automobiles or other property. The bill does not repeal all recordkeeping requirements for traveling expenses, etc. Indeed, the bill reinstates the prior-law substantiation requirements of section 274(d) as in effect prior to the 1984 Act amendments, with two modifications. First, a taxpayer who fails to maintain adequate records can substantiate expenditures subject to section 274(d) only by sufficient written evidence corroborating his or her own statement; oral evidence alone is not sufficient as corroboration for this purpose. Second, automobile expenses are made subject to the reinstated section 274(d) substantiation rules, effective for taxable years beginning after 1985; thus, such expenses are treated in the same manner as traveling expenses away from home.

In view of the budget deficit, the committee concluded that it is appropriate to balance the revenue loss resulting from the provisions of the bill repealing certain compliance rules enacted in the 1984 Act by adjusting the limitations set forth in section 280F on

the investment tax credit and depreciation deductions for automobiles.

## C. EXPLANATION OF PROVISIONS

### *1. Repeal of 1984 Act provisions*

*Repeal of "contemporaneous"*

The bill repeals the word "contemporaneous" from Code section 274(d) as if it had never been a part of that section. The bill also provides that the Internal Revenue Code is to be applied and administered as if the word "contemporaneous" had never been added to section 274(d).

*Repeal of return preparer's provision*

The bill repeals the provision of the 1984 Act requiring that a return preparer must specifically advise the taxpayer of the recordkeeping requirements of section 274(d) and must obtain written confirmation from the taxpayer that adequate contemporaneous records existed to support the claimed deductions or credits (Code sec. 6695(b)). The bill provides that the Internal Revenue Code shall be applied and administered as if this provision had never been enacted.

The committee believes that it is inappropriate to single out this one area of recordkeeping for special requirements, since return preparers already are responsible for the overall substantive accuracy of the preparation of the return. Also, because the committee intends (see below) that taxpayers claiming tax credits or depreciation for the use of automobiles and other listed property must indicate on the tax return whether the taxpayer has adequate records or sufficient written evidence supporting the claimed deductions and credits, the return preparer requirement is not needed. That is, if a return preparer signed a return that both claimed a deduction for the business use of a car and indicated that the taxpayer did not have the evidence required by the statute to justify the claims, the return preparer would be subject to existing penalties.

*Repeal of special negligence penalty*

The bill also repeals the provision of the 1984 Act providing a special negligence penalty rule applicable to an underpayment of tax attributable to a failure to comply with the recordkeeping requirements of section 274(d). The bill provides that the Internal Revenue Code shall be applied and administered as if this provision had never been enacted.

The committee believes that repealing this portion of the negligence penalty is needed to restore to the Internal Revenue Service and the courts discretion not to impose the negligence penalty for minor, inadvertent recordkeeping or computational errors. The committee emphasizes, however, that the regular negligence and fraud penalties will continue to be applicable if a taxpayer claims tax benefits that cannot be supported. The committee is concerned that these negligence and fraud penalties have not been applied by the Internal Revenue Service or the courts in a substantial number of instances where their application would be fully justified.

In one Tax Court case, for example, the taxpayer had kept detailed mileage records, required by his employer for reimbursement purposes, that indicated that his business use was approximately five percent of total use. On his tax return, the taxpayer claimed 70 percent business use, with no records to justify this claim. The Tax Court properly allowed only five percent business use. The Court did not, however, impose a negligence or fraud penalty. The committee believes that, in a case like this one, the negligence penalty should certainly be imposed, and that careful consideration should be given to imposing the civil fraud penalty.

In another Tax Court case, the taxpayer had kept detailed records so that he could be reimbursed by his employer, but claimed on his tax return approximately 35,000 miles of business use beyond what his records demonstrated, without any justification. No negligence penalty was imposed. In another case, the taxpayer produced a diary purporting to justify the claimed deductions. The Tax Court called the diary a "fabrication" and said that the taxpayer "was not telling the truth." The Court still permitted him a deduction, and did not impose the negligence or civil fraud penalty. Finally, another taxpayer apparently claimed a deduction for business mileage that exceeded the total mileage shown on his odometer, but the Tax Court did not impose a negligence or civil fraud penalty.

These cases indicate that the negligence and civil fraud penalties are not being administered by either the Internal Revenue Service or the courts in the manner that the Congress intended when it initially enacted these penalties. While minor, inadvertent record-keeping or computational errors should not lead to the imposition of a substantial penalty, the committee believes that it is vital to the integrity of the tax system that honest taxpayers know that others who claim tax benefits far in excess of what can be justified will be subject to the negligence and fraud penalties.

*Repeal of regulations*

The bill repeals all Treasury Regulations (temporary or proposed) issued prior to the enactment of the bill that carry out the amendments made by section 179(b) of the Tax Reform Act of 1984. Thus, regulations issued to implement the changes to section 274(d) made by that Act, particularly the inclusion in that section of the word "contemporaneous," are revoked.[5] In addition, any regulations relating to the return preparer provision and the special negligence penalty (described above) are revoked.[6] These revoked regulations are to have no force and effect whatsoever.[7]

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[5] Also, the regulations prohibiting the employer from including the entire value of the use of the automobile in the income of certain employees are revoked.

[6] The regulations relating to valuation issued under sections 61 and 132 are not, however, revoked.

[7] The committee revokes the regulations that provide for safe harbors for the use of highway vehicles. This change does not prohibit Treasury from developing similar safe harbors. To the extent that Treasury considers reinstating these safe harbors, the committee believes that Treasury should consider whether the standard requiring that farmers derive 70% of their income from farming may be too high.

*2. Definition of adequate records*

*In general*

The bill amends section 274 to require that taxpayers must maintain adequate records or sufficient written evidence corroborating the taxpayer's own statement to support the credits or deductions they are claiming.

The bill specifies that, in the alternate substantiation test, the sufficient corroborating evidence must be written. The committee believes that it is appropriate to require that taxpayers maintain written evidence to support their claims of tax credits and deductions. The written evidence must exist by the time tax return is filed.[8]

More specifically, in the case of travel, the committee intends that these records or evidence support the deductions or credits claimed. Adequate records or sufficient written evidence includes the following:

a. Account books
b. Diaries
c. Logs
d. Documentary evidence (receipts, paid bills)
e. Trip sheets
f. Expense reports
g. If the employee is required to make an adequate accounting to the employer and the reimbursement equals expenses, the employee is not required to report the expenses and reimbursement on his tax return
h. Written statements of witnesses

All of these types of documentation were specifically approved under prior law. The committee specifically approves of these means of documentation, and considers the longstanding Treasury Regulations on recordkeeping issued under section 274(d)[9] prior to the 1984 Act to reflect accurately its intent as to the documentation that taxpayers are required to maintain, except insofar as those regulations authorize the use of sufficient oral evidence corroborating the taxpayer's own statements and except that the written evidence must be compiled by the time the return is filed. The committee also believes that case law under section 274(d) generally reflects appropriate standards of recordkeeping, except insofar as those cases authorize the use of oral evidence corroborating the taxpayer's own statement. While taxpayers may choose to keep contemporaneous logs on the use of their automobiles, the Treasury is specifically prohibited from requiring that all taxpayers keep daily contemporaneous logs of their use of the automobile.

The committee believes that the written policy statements kept by the employer to implement a policy of no personal use (or no personal use except for commuting) qualify as sufficient written evidence corroborating the taxpayer's own statement. Therefore, the employee will not need to keep records under section 274(d) for

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[8] In a few instances, the courts had permitted taxpayers to deduct amounts solely on the basis of oral evidence. The committee believes that requiring written evidence will be beneficial to taxpayers, because they will compile the necessary information by the time the tax return is filed.

[9] See Treas. Reg. sec. 1.274-5, initially published in the *Federal Register* on December 29, 1962.

the use of a vehicle that qualifies under either of these provisions. A written policy statement adopted by a governmental unit would be eligible for this rule. Thus, a resolution of the city council or a provision of state law or the state constitution would qualify, so long as the conditions described below are met.

The committee wants to continue the provision in the recent regulations that provided that no recordkeeping under section 274(d) is required if the employer provides a vehicle to an employee and prohibits personal use by the employee. In order to be eligible for this special rule, the following conditions must be met—

(a) The vehicle owned or leased by the employer is provided to one or more employees for use in connection with the employer's trade or business;

(2) When the vehicle is not being used for such business purposes, it is kept on the employer's business premises (or temporarily located elsewhere, e.g., for repair);

(3) Under the employer's policy, no employee may use the vehicle for personal purposes, other than de minimis personal use (such as a stop for lunch between two business deliveries);

(4) The employer reasonably believes that no employee uses the vehicle, other than de minimis use, for any personal purpose; and

(5) No employee using the vehicle lives at the employer's business premises.

To utilize this exception to the otherwise applicable substantiation requirement, there must be evidence that would enable the Internal Revenue Service to determine whether the use of the vehicle met the five conditions listed in the preceding paragraph.

The committee also wants to continue the provision in the recent regulations that provided that no recordkeeping under section 274(d) is required if the employer provides a vehicle to a specified employee and prohibits personal use by the employee, except for commuting. In order to be eligible for this rule, the following conditions must be met—

(1) The vehicle owned or leased by the employer is provided to one or more employees for use in connection with the employer's trade or business and is used in the employer's trade or business;

(2) For bona fide noncompensatory business reasons, the employer requires the employee to commute to and/or from work in the vehicle;

(3) The employer establishes a policy under which the employee may not use the vehicle for personal purposes, other than commuting or de minimis personal use (such as a stop for a personal errand between a business delivery and the employee's home);

(4) The employer reasonably believes that, except for de minimis use, the employee does not use the vehicle for any personal purpose other than commuting; and

(5) The employer accounts for the commuting use by including an appropriate amount in the employee's gross income. This special exception to the substantiation rule is not available if the employee using the vehicle for commuting is an officer or one-percent owner of the employer.

In order to utilize this exception to the otherwise applicable substantiation requirements, there must be evidence that would enable the Internal Revenue Service to determine whether the use of the vehicle meets the conditions set forth in the preceding paragraphs.

*Information required on return*

The committee wants to ensure that taxpayers claim only the deductions to which they are entitled without being unduly burdened by complex recordkeeping requirements. The committee also believes that taxpayers should provide sufficient information on their returns so that the Internal Revenue Service can make a preliminary evaluation of the appropriateness of the taxpayer's claimed deductions. Previously, the Internal Revenue Service found it difficult to make this sort of preliminary evaluation without auditing the taxpayer, which can also be a significant burden on the taxpayer. Therefore, the committee believes that taxpayers should all answer a few short questions on their returns if they claim the tax benefits for the business use of an automobile.

The committee believes that taxpayers will not be significantly burdened by responding to a few questions, most of them requiring a yes or no response. The committee directs that the following questions appear on the tax return, to be answered by taxpayers claiming credits or deductions for the business use of an automobile:

1. Total number of miles driven during the year: miles.
2. Percentage of personal use claimed: %.
3. Was the vehicle used for commuting Yes No. If Yes, the distance normally commuted: miles.
4. Was the vehicle available for personal use in off duty hours Yes No.
5. Is another vehicle available for personal use Yes No.
6. I have adequate records or sufficient written evidence to justify these deductions Yes No. If no, no deduction is permitted.

The committee notes that the requirement that these questions be included on the tax forms does not appear in the bill because the Internal Revenue Code does not generally specify the format or specific content of forms. The Internal Revenue Code does not need to be amended to provide the authority to require these questions, since that authority already exists in sections 6001 and 6011.

The committee intends that employees who claim deductions or credits for business use of their own car be asked these questions on Form 2106 (relating to employee business expenses); some of this information is already required to be provided on that form. Unincorporated taxpayers who claim these credits or deductions on either Schedules C or F (or on some other form) will be asked these questions on that form. Corporate taxpayers, as well as all other taxpayers and entities, will be asked these questions on the forms they are required to file.

The committee intends that employees give this information to their employers if the employer provided the car. Generally, the

employer would put this information on its tax return, since the employer is claiming the tax benefits of the use of the car. Employers who provide more than 5 cars to employees, however, would not have to include this information on the employer's return; the Internal Revenue Sevice could examine on audit the information that the employees provide to the employer. The employer would have to indicate on his return that he has received this information from the employees. The employer can rely on the employee's statement (unless the employer has reason to know it is false) to determine the credits and deductions to which the employer is entitled and to determine the amount of income, if any, the employer must include in the employee's income because of the employee's personal use of the employer's car.

The committee intends that similar questions be asked on the tax return about other listed property, such as yachts, airplanes, and computers. For computers, for example, the following questions should be asked:

1. Percentage of personal use claimed: %.
2. Was the computer located at your place of business or your home or both. If both, what percentage of the year was it at home: %.
3. Do you have records or written evidence to justify these deductions Yes No.

*3. Vehicles with no personal use*

The bill provides that any vehicle that by reason of its nature is not likely to be used more than a de minimis amount for personal purposes is exempt from the recordkeeping requirements of section 274(d).

The committee believes that this is an appropriate exemption from the recordkeeping requirements of section 274(d) because one of the purposes of those recordkeeping requirements is to ensure that taxpayers do not deduct as a business expense an expense that is really personal in nature. This purpose does not apply to a vehicle the characteristics of which make it highly unlikely that it will be used more than a very minimal amount for personal purposes. Consequently, the committee believes that it is appropriate to exempt these vehicles from the recordkeeping requirements of section 274(d). Taxpayers will still have to justify their claimed deductions for these vehicles as required under either section 162 or 212, which are the general provisions relating to business deductions.

The Internal Revenue Service had listed in its recent regulations under section 274(d) several examples of vehicles that by their nature are not likely to be used more than a de minimis amount for personal purposes:

a. forklifts,
b. cement mixers,
c. dump trucks (including garbage trucks),
d. refrigerated trucks,
e. tractors, and
f. combines.

The committee intends that these types of vehicles continue to be considered to be not susceptible to personal use. In addition, the committee believes that there are other types of vehicles that, be-

cause of their inherent nature or characteristics, are unlikely to be used more than a very minimal amount for personal purposes. The committee has identified the following types of vehicles as meeting this criterion:

a. delivery trucks with seating only for the driver,[10]
b. flatbed trucks,
c. any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds,
d. passenger buses used as such with a capacity of at least 20 passengers,
e. clearly marked police and fire vehicles,
f. ambulances used as such,
g. hearses used as such,
h. bucket trucks ("cherry pickers"),
i. cranes, and
j. derricks.

The committee recognizes that it may not have developed an exhaustive list of vehicles not susceptible to personal use. Therefore, the committee intends that the Internal Revenue Service expand this list through either regulations or revenue rulings to include those vehicles that the committee may not have included in this listing but that are appropriate for listing because by their nature it is highly unlikely that they will be used more than a very minimal amount for personal purposes.

A clearly marked police or fire vehicle is a vehicle, owned or leased by a governmental unit, that is clearly marked (through painted insignia or words) as a police or fire vehicle, the markings on which make it readily apparent that it is a police or fire vehicle. A marking on a license plate is not a clear marking.

The committee expects that it is appropriate for Treasury to provide in regulations that under certain conditions all use of such vehicles by an employee is excluded, as a working condition fringe benefit, from the employee's income and wages. If, for example, an employer requires, for bona fide business reasons, that the employee takes such a vehicle to his or her home when the employee is not working and that no personal use (e.g., shopping or recreation) is made of the vehicle, then all use of the vehicle could be considered business use which would be deductible under section 162, and thus excluded from income under section 132(d) as a working condition fringe.

The committee has not generally exempted from the recordkeeping requirement all pickup trucks and vans, because these vehicles can be easily used for personal purposes. Some taxpayers purchase these vehicles as substitutes for passenger sedans, and use them predominantly (or entirely) for personal purposes. One article has noted that, should vans be exempted, "taxpayers will have an opportunity to acquire luxury passenger vehicles with full tax benefits." On the other hand, however, the committee recognizes that this is not applicable to all vans. For example, a van that has only a front bench for seating, in which permanent shelving has been

[10] A vehicle with a jump seat (i.e., a seat that folds up flat) in addition to the seat only for the driver would also qualify.

installed, that constantly carries merchandise, and that has been specially painted with advertising or the company's name, is a vehicle not susceptible to personal use.

*4. Withholding elections*

As authorized by the legislative history of the 1984 Act, the Internal Revenue Service has provided (in temporary regulations) that an employer may withhold income and employment taxes due on taxable fringe benefits provided to an employee on a quarterly basis. For example, if the employee receives a $100 taxable benefit on January 10, withholding can be deferred by treating the benefit as paid on March 31.

The committee intends that the regulations are to be revised to allow an employer to elect, for income and employment tax purposes, to treat taxable fringe benefits (including personal use of employer-provided automobiles) as paid on a pay period, quarterly, semi-annual, or annual basis. Thus, in the example above, withholding could be deferred by treating the benefit as paid on June 30 or December 31.

In addition, the bill provides that an employer could elect not to withhold income taxes on the value of the personal use of an automobile that is included in the employee's income if (1) the employer gives the employee advance written notice of this election that nonwithholding is implemented as to that employee and (2) the employer includes the taxable amount of the benefit in the employee's income as reported on the Form W-2 provided by the employer to the employee for the year in which such benefit is received.[11] This election does not apply to FICA or RRTA taxes. The advance notice generally must be provided to the employee by January 1 of the year as to which the election is to apply; if an election is made for 1985, the notice must be provided by July 1, 1985. If the employer elects not to withhold income taxes, the employee can increase his withholding from regular wages by adjusting his Form W-4 so that the employee does not need to make estimated tax payments.

*5. Limitations on ITC and depreciation*

The bill reduces the limits on the amount of investment tax credit and annual depreciation decuctions that are allowed for an automobile as follows: (1) the investment tax credit is limited to $675; (2) depreciation in the first year is limited to $3600; and (3) depreciation in any subsequent year is limited to $5400.

For years after 1985, the limits provided in the bill are indexed for inflation, as measured by the percentage growth of the automobile component of the Consumer Price Index for All Urban Consumers between October of the preceding year and October 1984. Adjustments for inflation are otherwise determined as under present law. The committee intends that the Secretary of the Treasury shall prescribe the adjusted limits.

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[11] These amounts will be treated as withheld upon for purposes of 280F(d)(6)(C)(i)(III).

D. EFFECTIVE DATES

*Substantiation rules*

The repeal of word "contemporaneous" from section 274(d) and the repeal of the return preparer's provision and the special negligence penalty enacted in the 1984 Act are effective as if those provisions had never been included in the 1984 Act.

The amendments to section 274(d) as reinstated—(1) providing that the evidence which can corroborate the taxpayer's own statement, in the absence of adequate records, is written evidence and (2) modifying the types of items subject to section 274(d)—are effective for taxable years beginning after December 31, 1985. The Internal Revenue Service is required to issue the regulations carrying out the provisions of the bill no later than October 1, 1985. This should give taxpayers sufficient time to prepare to comply with the provisions of this bill.

For taxable years beginning in 1985, the bill provides that prior law relating to recordkeeping applies. The committee believes that, because of the confusion that has existed since the start of the current year as to what recordkeeping requirements taxpayers would have to follow, taxpayers should be permitted for the current year to follow the rules that were in effect before the 1984 Act.

*Limitations on ITC and depreciation*

In general, the reduced limits on the investment tax credit and depreciaiton are effective for property placed in service by the taxpayer or leased by the taxpayer after April 2, 1985. However, property acquired by the taxpayer pursuant to a binding contract in effect on April 1, 1985, and at all times thereafter, is not subject to the reduced limits provided by the bill, if it is placed in service before August 1, 1985; and property of which the taxpayer is the lessee pursuant to a binding contract in effect on April 1, 1985, and all times thereafter, is not subject to the reduced limits if the taxpayer first uses the property under the lease before August 1, 1985. The reduced limits on the investment tax credit and depreciation are effective for the remainder of 1985; in 1986, those limits are indexed.

## II. Budget Effects

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effect on the budget of the bill (H.R. 1869) as reported by the committee. The provisions of the bill as reported are estimated to decrease fiscal year budget receipts by $67 million in 1985, by $4 million in 1986, and increase receipts by $4 million in 1987, by $46 million in 1988, by $52 million in 1989, and by $57 million in 1990.

The Treasury Department agrees with this statement of budget effect.

## III. Vote of the Committee and Other Matters To Be Discussed Under House Rules

### A VOTE OF THE COMMITTEE

In compliance with clause 3(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made concerning the vote of the committee on the motion to report H.R. 1869. The bill, as amended, was ordered favorable reported by by voice vote.

### B. OTHER MATTERS

In compliance with clauses 2(l)(3) and 2(l)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made with respect to the committee action H.R. 1869.

*Oversight findings*

With respect to subdivision (A) of clause 2(l)(3) (relating to oversight findings), the committee advises that it was a result of the committee's review of the effect on individuals and businesses of the contemporaneous recordkeeping requirements enacted in the Tax Reform Act of 1984, as interpreted in temporary regulations issued by the IRS on October 15, 1984 and February 15, 1985, that the committee concluded that it is appropriate to repeal the contemporaneous requirements, to repeal the IRS temporary regulations interpreting that requirement, and to reinstate the prior law substantiation rules under Code section 274(d), with certain modifications. The committee held a hearing on this subject on March 5, 1985.

*Tax expenditures*

With respect to subdivision (B) of clause 2(l)(3), after consultation with the Director of the Congressional Budget Office, the committee states that the changes made by the bill as reported involve fiscal year decreases in tax expenditures of $17 million in 1985, $97 million in 1986, $130 million in 1987, $138 million in 1988, $144 million in 1989, and $151 million in 1990.

*New budget authority*

With respect to subdivision (B) of clause 2(l)(3) after consultation with the Director of the Congressional Budget Office, the committee states that the changes made by the bill as reported involve no new budget authority.

*Congressional Budget Office estimates*

Because of time constraints, it is not feasible to present a letter from the Director of the Congressional Budget Office before the bill is filed.

*Oversight by Committee on Government Operations*

With respect to subdivision (D) of clause 2(l)(3), the committee advises that no oversight findings or recommendations have been submitted to the Committee on Government Operations regarding the subject matter of the bill.

*Inflationary impact*

In compliance with clause 2(l)(4), the committee states that the enactment of the bill is not expected to have any inflationary impact on prices and costs in the operation of the national economy.

IV. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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## Subtitle A—Income Taxes

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## CHAPTER 1—NORMAL TAXES AND SURTAXES

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### Subchapter B—Computation of Taxable Income

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### PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

(a) ENTERTAINMENT, AMUSEMENT OR RECREATION.—

(1) IN GENERAL.—* * *

* * * * * * *

(d) SUBSTANTIATION REQUIRED.—No deduction or credit shall be allowed—

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

(2) for any item with respect to an acitivity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity,

(3) for any expense for gifts, or

(4) with respect to any listed property (as defined in section 280F(d)(4)),

unless the taxpayer substantiates by adequate [contemporaneous] records *or sufficient written evidence corroborating the taxpayer's own statement* (A) the amount of such expense or other item, (B) the time and place of the travel, entertainment, amusement, recre-

ation, or use of the facility or property, or the date and description of the gift, (C) the business purpose of the expense or other items, and (D) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. *This subsection shall not apply to any qualified nonpersonal use vehicle (as defined in subsection (i)).*

* * * * * * *

*(i) QUALIFIED NONPERSONAL USE VEHICLE.—For purposes of subsection (d), the term "qualified nonpersonnal use vehicle" means any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes.*

**[**(i)**]***(j)* REGULATORY AUTHORITY.—The Secretary shall prescribe such regulations as he may deem necessary to carry out the purposes of this section, including regulations prescribing whether subsection (a) or subsection (b) applies in cases where both such subsections would otherwise apply.

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SEC. 280F. LIMITATION ON INVESTMENT TAX CREDIT AND DEPRECIATION FOR LUXURY AUTOMOBILES; LIMITATION WHERE CERTAIN PROPERTY USED FOR PERSONAL PURPOSES.

(a) LIMITATION ON AMOUNT OF INVESTMENT TAX CREDIT AND DEPRECIATION FOR LUXURY AUTOMOBILES.—

(1) INVESTMENT TAX CREDIT.—The amount of the credit determined under section 46(a) for any passenger automobile shall not exceed **[**$1,000.**]** *$675.*

(2) DEPRECIATION.—

(A) LIMITATION.—The amount of the recovery deduction for any taxable year for any passenger automobile shall not exceed—

(i) **[**$4,000**]** *$3,600* for the first taxable year in the recovery period, and

(ii) **[**$6,000**]** *$5,400* for each succeeding taxable year in the recovery period.

(B) DISALLOWED DEDUCTIONS ALLOWED FOR YEARS AFTER RECOVERY PERIOD.—

(i) IN GENERAL.—Except as provided in clause (ii), the unrecovered basis of any passenger automobile shall be treated as an expense for the 1st taxable year after the recovery period. Any excess of the unrecovered basis over the limitation of clause (ii) shall be treated as an expense in the succeeding taxable year.

(ii) **[**$6,000**]** *$5,400* LIMITATION.—The amount treated as an expense under clause (i) for any taxable year shall not exceed **[**$6,000**]** *$5,400.*

(iii) PROPERTY MUST BE DEPRECIABLE.—No amount shall be allowable as a deduction by reason of this subparagraph with respect to any property for any taxable year unless a depreciation deduction would be al-

lowable with respect to such property for such taxable year.

(iv) AMOUNT TREATED AS RECOVERY DEDUCTION.—For purposes of this subtitle, any amount allowable as a deduction by reason of this subparagraph shall be treated as a recovery deduction allowable under section 168.

(3) COORDINATION WITH REDUCTIONS IN AMOUNT ALLOWABLE BY REASON OF PERSONAL USE, ETC.—This subsection shall be applied before—

(A) the application of subsection (b), and

(B) the application of any other reduction in the amount of the credit determined under section 46(a) or any recovery deduction allowable under section 168 by reason of any use not qualifying the property for such credit or recovery deduction.

(4) SPECIAL RULE WHERE ELECTION OF REDUCED CREDIT IN LIEU OF THE BASIS ADJUSTMENT.—In the case of any election under section 48(q)(4) with respect to any passenger automobile, the limitation of paragraph (1) applicable to such passenger automobile shall be ⅔ of the amount which would be so applicable but for this paragraph.

* * * * * * *

(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) COORDINATION WITH SECTION 179.—Any deduction allowable under section 179 with respect to any listed property shall be subject to the limitations of subsections (a) and (b) in the same manner as if it were a recovery deduction allowable under section 168.

(2) SUBSEQUENT DEPRECIATION DEDUCTIONS REDUCED FOR DEDUCTIONS ALLOCABLE TO PERSONAL USE.—Solely for purposes of determining the amount of the recovery deduction for subsequent taxable years, if less than 100 percent of the use of any listed property during any taxable year is not use described in section 168(c)(1) (defining recovery property), all of the use of such property during such taxable year shall be treated as use so described.

(3) DEDUCTIONS OF EMPLOYEE.—

(A) IN GENERAL.—Any employee use of listed property shall not be treated as use in a trade or business for purposes of determining the amount of any credit allowable under section 38 to the employee or the amount of any recovery deduction allowable to the employee unless such use is for the convenience of the employer and required as a condition of employment.

(B) EMPLOYEE USE.—For purposes of subparagraph (A), the term "employee use" means any use in connection with the performance of services as an employee.

(4) LISTED PROPERTY.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term "listed property" means—

(i) any passenger automobile,

(ii) any other property used as a means of transportation,

(iii) any property of a type generally used for purposes of entertainment, recreation, or amusement,

(iv) any computer or peripheral equipment (as defined in section 168(j)(5)(D)), and

(v) any other property of a type specified by the Secretary by regulations.

(B) EXCEPTION FOR CERTAIN COMPUTERS.—The term "listed property" shall not include any computer or peripheral equipment (as so defined) used exclusively at a regular business establishment. For purposes of the preceding sentence, any portion of a dwelling unit shall be treated as a regular business establishment if (and only if) the requirements of section 280A(c)(1) are met with respect to such portion.

(5) PASSENGER AUTOMOBILE.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term "passenger automobile" means any 4-wheeled vehicle—

(i) which is manufactured primarily for use on public streets, roads, and highways, and

(ii) which is rated at 6,000 pounds gross vehicle weight or less.

(B) EXCEPTION FOR CERTAIN VEHICLES.—The term "passenger automobile" shall not include—

(i) any ambulance, hearse, or combination ambulance/hearse used by the taxpayer directly in a trade or business,

(ii) any vehicle used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire, and

(iii) under regulations, any truck or van.

(6) BUSINESS USE PERCENTAGE.—

(A) IN GENERAL.—The term "business use percentage" means the percentage of the use of any listed property during any taxable year which is a qualified business use.

(B) QUALIFIED BUSINESS USE.—Except as provided in subparagraph (C), the term "qualified business use" means any use in a trade or business of the taxpayer.

(C) EXCEPTION FOR CERTAIN USE BY 5-PERCENT OWNERS AND RELATED PERSONS.—

(i) IN GENERAL.—The term "qualified business use" shall not include—

(I) leasing property to any 5-percent owner or related person,

(II) use of property provided as compensation for the performance of services by a 5-percent owner or related person, or

(III) use of property provided as compensation for the performance of services by any person not described in subclause (II) unless an amount is included in the gross income of such person with re-

spect to such use, and, where required, there was withholding under chapter 24.

(ii) SPECIAL RULE FOR AIRCRAFT.—Clause (i) shall not apply with respect to any aircraft if at least 25 percent of the total use of the aircraft during the taxable year consists of qualified business use not described in clause (i).

(D) DEFINITIONS.—For purposes of this paragraph—

(i) 5-PERCENT OWNER.—The term "5-percent owner" means any person who is a 5-percent owner with respect to the taxpayer (as defined in section 416(i)(1)(B)(i)).

(ii) RELATED PERSON.—The term "related person" means any person related to the taxpayer (within the meaning of section 267(b)).

(7) AUTOMOBILE PRICE INFLATION ADJUSTMENT.—

(A) IN GENERAL.—In the case of any passenger automobile, subsection (a) shall be applied by increasing each dollar amount contained in such subsection by the automobile price inflation adjustment for the calendar year in which such automobile is placed in service. Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or if the increase is a multiple of $50, such increase shall be increased to the next higher multiple of $100).

(B) AUTOMOBILE PRICE INFLATION ADJUSTMENT.—For purposes of this paragraph—

(i) IN GENERAL.—The automobile price inflation adjustment for any calendar year is the percentage (if any) by which—

(I) the CBI automobile component for October of the preceding calendar year, exceeds

(II) the CBI automobile component for October of [1983.] *1984.*

In the case of [calendar year 1984,] *any calendar year before 1986,* the automobile price inflation adjustment shall be zero.

(ii) CPI AUTOMOBILE COMPONENT.—The term "CPI automobile component" means the automobile component of the Consumer Price Index for All Urban Consumers published by the Department of Labor.

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## Subtitle C—Employment Taxes and Collection of Income Tax at Source

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## CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

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SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) REQUIREMENT OF WITHHOLDING.—

(1) IN GENERAL.—* * *

* * * * * * *

*(s) EXEMPTION FROM WITHHOLDING FOR ANY VEHICLE FRINGE BENEFIT.—*

*(1) EMPLOYER ELECTION NOT TO WITHHOLD.—The employer may elect not to deduct and withhold any tax under this chapter with respect to any vehicle fringe benefit provided to any employee if such employee is notified (at such time and in such manner as the Secretary shall by requlations prescribe) by the employer that the employer is making such election. The preceding sentence shall not apply to any vehicle fringe benefit unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051.*

*(2) EMPLOYER MUST FURNISH W-2.—Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter for purposes of section 6051.*

*(3) VEHICLE FRINGE BENEFIT.—For purposes of this subsection, the term "vehicle fringe benefit" means any fringe benefit—*

*(A) which constitutes wages (as defined in section 3401), and*

*(B) which consists of providing a highway motor vehicle for the use of the employee.*

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SECTION 179 OF THE TAX REFORM ACT OF 1984

SEC. 179. LIMITATION ON AMOUNT OF DEPRECIATION AND INVESTMENT TAX CREDIT FOR LUXURY AUTOMOBILES; LIMITATION WHERE CERTAIN PROPERTY USED FOR PERSONAL PURPOSES.

(a) IN GENERAL.—* * *

(b) COMPLIANCE PROVISIONS.—

(1) AMENDMENT OF SECTION 274 (d).—* * *

[(2) DUTIES OF RETURN PREPARERS.—Subsection (b) of section 6695 (relating to failure to sign return) is amended to read as follows:

["(b) FAILURE TO INFORM TAXPAYER OF CERTAIN RECORDKEEPING REQUIREMENTS OR TO SIGN RETURN.—Any person who is an income tax return preparer with respect to any return or claim for refund and who is required by regulations to sign such return or claim—

["(1) shall advise the taxpayer of the substantiation requirements of section 274(d) and obtain written confirmation from the taxpayer that such requirements were met with respect to any deduction or credit claimed on such return or claim for refund and

["(2) shall sign such return or claim for refund.

Any person who fails to comply with the requirements of the preceding sentence with respect to any return or claim shall pay a

penalty of $25 for such failure, unless it is shown that such failure is due to reasonable cause and not to willful neglect."

[(3) UNDERPAYMENT ATTRIBUTABLE TO FAILURE TO MEET SUBSTANTIATION REQUIREMENTS TREATED AS DUE TO NEGLIGENCE.—Section 6653 (relating to failure to pay tax) is amended by adding at the end thereof the following new subsection:

["(h) SPECIAL RULE IN THE CASE OF UNDERPAYMENT ATTRIBUTABLE TO FAILURE TO MEET CERTAIN SUBSTANTIATION REQUIREMENTS.—

["(1) IN GENERAL.—Any portion of an underpayment attributable to a failure to comply with the requirements of section 274(d) shall be treated, for purposes of subsection (a), as due to negligence in the absence of clear and convincing evidence to the contrary.

["(2) PENALTY TO APPLY ONLY TO PORTION OF UNDERPAYMENT DUE TO FAILURE TO MEET SUBSTANTIATION REQUIREMENTS.—If any penalty is imposed under subsection (a) by reason of paragraph (1), the amount of the penalty imposed by paragraph (1) of subsection (a) shall be 5 percent of the portion of the underpayment which is attributable to the failure described in paragraph (1)."]

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99TH CONGRESS
*1st Session*
HOUSE OF REPRESENTATIVES
REPORT
99-35

# ACTION TO RESPOND TO THE UNFAIR TRADE PRACTICES OF JAPAN AND TO REDUCE THE TRADE DEFICIT

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APRIL 1, 1985.—Referred to the House Calendar and ordered to be printed

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Mr. ROSTENKOWSKI, from the Committee on Ways and Means, submitted the following

## REPORT

[To accompany H. Con. Res. 107]

The Committee on Ways and Means, to whom was referred the concurrent resolution (H. Con. Res. 107) to express the sense of the Congress that the President take action to reduce the growing United States merchandise trade deficit and that he take action to respond to unfair international trade practices of Japan, having considered the same, report favorably thereon without amendment and recommend that the concurrent resolution do pass.

### COMMITTEE REPORT ON HOUSE CONCURRENT RESOLUTION 107

To express the sense of the Congress that the President take action to reduce the growing United States merchandise trade deficit and that he take action to respond to unfair international trade practices of Japan.

The U.S. merchandise trade deficit has tripled in three short years, growing to $123 billion in 1984 from $36 billion in 1982. The deficit threatens to rise to an even larger $140 to $150 billion in 1985. A trade deficit of this size is alarming, both because of the erosion it implies for our exporting and import-competing sectors, but also because of what it says about our ability to manage the U.S. economy in a sound and responsible way.

Clearly, not all factors underlying the U.S. trade deficit can or should be altered by policymakers in the United States—e.g. the debt problems of a number of developing countries and the robust growth of the U.S. economy. However, there are other factors contributing to the enormous merchandise trade deficit which would appropriately be addressed by U.S. policymakers. Among these other factors is the high value of the dollar against other currencies.

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Most economists, including those in the Administration, believe the strong dollar accounts for at least half of the U.S. trade deficit, acting as it does as a subsidy on imports and a tax on exports. If the budget deficit could be reduced, thereby reducing the need to import such massive amounts of capital to finance the simultaneously strong credit demands of business and the Federal government, the dollar could be eased gradually from its current high levels. Such action would help restore the competitiveness of U.S. exports and would provide needed stimulus to the trading sector of our economy, which has been largely by-passed by the recent economic recovery.

Equally clearly, Japan is not the primary source of the U.S. trade deficit. The U.S. trade balance with the European Community since 1980 has deteriorated by a relatively much greater amount than with Japan, and our trade balances with Canada and the developing countries as a whole have suffered badly in recent years.

However, if the United States is to maintain relatively open markets in the face of intense pressure from many industries to erect protectionist barriers, there must be a sense that competitive U.S. products have access to foreign markets on a fair and equitable basis. This sense exists, with some exceptions, with respect to U.S. market access in Europe, Canada, and many developing countries. Where such access is denied or restricted, it usually is due to selected and readily identifiable barriers affecting imports in a particular sector.

However, this sense does not generally exist with respect to Japan; and the belief is not unique to American exporters. Rather, many producers in the United States and other countries have the sense that even the most competitive goods from whatever source—textiles or steel from neighboring countries in Southeast Asia or telecommunications products from the United States—often are not able to enter the Japanese market freely, particularly if such imports would threaten to take a large share of the Japanese market from Japanese producers.

Although there is no one measure available to determine whether an economy is "open", the following figures would suggest that as the Free World's second largest economy, Japan could do more to open its economy to manufactured imports. This is true despite Japan's heavy reliance on imported raw materials, which means that raw materials will account for a relatively larger share of Japan's total imports.

According to Administration estimates, the United States imports about 58 percent of all manufactured goods exported by developing countries. Europe imports about 23 percent; and Japan imports about 8 percent. By any measure, it would seem difficult to attribute such an unequal distribution of developing country manufactured exports solely to Japan's dependence on raw material imports.

As most economies expand and remove import barriers, the importance of manufactured imports has grown, in most cases substantially. In the European Community [EC], for example, imports of manufactured goods now account for about one quarter of all manufactures consumed within the EC; that share has grown from 16 percent in 1970. In the United States, imports also account for

about one quarter of all manufactured goods consumed in this country; that share is more than double the share of 11 percent in 1970. In the case of Japan, imports account for about 13 percent of all manufactured goods consumed in Japan; that share is up comparatively little from the share of 10 percent in 1970.

While Japan is much more dependent on imports of raw materials than either the EC or the United States, one nonetheless would expect a truly open economy to show greater integration of manufactured imports into the economy over the period of a one and a half decades, a period during which Japan dismantled a host of barriers to imports of manufactured goods.

Finally, while it is not widely recognized, the yen has been rising along with the dollar since mid-1980 and has reached record highs against currencies in Europe and elsewhere. Japanese officials have rightly placed much of the blame for the large U.S. trade deficit on the effects of the strong dollar. However, an examination of Japan's trade balances against the major countries or regions which have experienced significant currency depreciation against the yen shows that Japan continues to run trade surpluses with virtually every major trading region except OPEC and other important suppliers of raw materials. For example, between 1980 and 1983 (latest year for which final figures are available), Japan's exports to neighboring countries in Southeast Asia rose from $31 billion to $35 billion, while Japan's imports from those countries fell from $32 billion to $28 billion. Japan's imports from Korea during that period were nearly stagnant, although the yen appreciated nearly 50 percent against the Korean won and Japan's economy grew about three percent per year in real terms. Similar patterns were repeated with respect to a number of European countries whose currencies depreciated against the yen. While partial figures for 1984 begin to show some improvement in this picture—that is, Japanese imports began to rebound, albeit not as rapidly as exports—questions remain as to why, if Japan's market were truly open, the strong yen has not led to a stronger growth of imports and weaker performance of exports.

The purpose of this resolution is to express sense of the Congress that now is the time for President and Administration to take firm action with regard to Japan to indicate to Japan the seriousness with which Congress views the difficulties of firms in the United States—and around the world—in their efforts to penetrate Japan's market. U.S. negotiators have spent many of the past fifteen years in negotiations with Japan, and despite a series of "market-opening" measures announced by Japan, we have seen little result in terms of increased market access for U.S. and other exporters.

In the current "Four Sector" negotiations—in telecommunications, electronics, forest products, and medical equipment and pharmaceuticals—we have seen an apparent reluctance on the part of Japanese negotiators to address potentially serious problems before they occur in telecommunications, and an apparent unwillingness to negotiate on high tariffs and other important barriers in forest products. Yet these are the very sectors which President Reagan and Prime Minister Nakasone agreed in their January meeting should be addressed on an urgent basis; they also are

among the sectors in which the leaders agreed the United States is internationally competitive.

On a broader front, the purpose of this Resolution is to express the sense of the Congress that the Administration and Congress must come to grips with some of the underlying causes of the overall merchandise trade deficit. Among these is the enormous budget deficit, which, when combined with the strong growth in demand for credit by private businesses and individuals, has substantially exceeded the pool of savings available in this country. This has necessitated the inflow of large amounts of capital from abroad to finance these credit demands, which in turn has pushed the value of the dollar up sharply on foreign exchange markets. Among the options available—reducing the borrowing requirements of either business or government—the choice is clear. Congress and the Administration must take immediate steps to begin reducing the massive budget deficits confronting this country and thereby increase the likelihood that the dollar will depreciate smoothly and improve U.S. international competitiveness.

## SECTION-BY-SECTION ANALYSIS

*Congressional findings*

House Concurrent Resolution 107 outlines a number of factors which form the basis for the actions which the President is urged to take under this resolution to reduce the growing U.S. merchandise trade deficit and respond to unfair trade practices of Japan.

The role of the strong dollar and the fiscal deficit in creating the unprecedented trade deficit of $123 billion in 1984 is acknowledged, and it is recognized that concerted Congressional and Presidential action is needed to address these problems to help restore U.S. competitiveness and reduce protectionist pressures.

However, the resolution also recognizes that the absence of fair and equitable access for U.S. and other manufacturers to the Japanese market, in spite of significant growth in the Japanese economy, and the fact that Japan has extensive access to the U.S. market, has been a substantial cause of the bilateral U.S. merchandise trade deficit with Japan of $37 billion in 1984. This disparity in market access, which also exists between Japan and most of its trading partners, has the potential of undermining the entire range of bilateral relations between the United States and Japan. Progress in the current negotiations on U.S. access to the Japanese markets in the telecommunication, forest products, pharmaceuticals and medical equipment sectors is essential to place our bilateral trade relationship on an equitable and mutually advantageous basis. Therefore, the resolution directs that the action described below be taken to enforce U.S. rights under trade agreements to which Japan is a party and to respond to Japanese acts and policies.

*Section 1*

Paragraph (1) directs the President to develop a concrete plan for reducing the overall trade deficit by attacking its causes, including the high value of the dollar on exchange markets. The 1984 trade deficit of $123 billion reflects an alarming trend. This figure is

nearly double the $69 billion 1983 trade deficit, which has increased from $40 billion in 1981. The traditional U.S. surplus in services trade, overseas investment income, and transfer payments also has declined; the U.S. current account swung from a surplus of over $4 billion in 1981 to a deficit of $41 billion in 1983 and about $100 billion in 1984.

Much of the trade deficit can be attributed to the strength of the dollar, which is now 25 to 30 percent higher than its average level during the entire eleven-year period of floating exchange rates. This results in an effective 25 to 30 percent surcharge on all U.S. exports and a 25 to 30 percent subsidy on all imports, making it extremely difficult for U.S. companies to compete in the international marketplace. Immediate steps must be taken to attack the causes of this trade deficit, including the strong dollar, in order to assure that U.S. products can compete on a fairer basis in U.S. and foreign markets.

Although paragraph (1) recognizes that not all of the current U.S. trade difficulties are the result of unfair trade practices by our trading partners, paragraph (2) of section 1 addresses the fundamental unfairness of the limited market access which Japan provides to competitive U.S. products, contributing substantially to the United States' $37 billion trade deficit with Japan.

The President is directed to take all appropriate and feasible action to secure the elimination of unreasonable and discriminatory Japanese acts, policies and practices which are inconsistent with or deny the United States the benefits of trade agreements to which Japan is a party. Although the U.S. market is wide open to Japanese imports, manufacturers of competitive U.S. products in a number of areas, such as telecommunications, pharmaceuticals, electronics, forest products and medical equipment face tremendous obstacles in entering the Japanese market. This disparity in treatment must be eliminated.

*Section 2*

Section 2 requires the President to make a determination, within 45 days after this concurrent resolution is agreed to by the Congress, as to whether Japan has taken sufficient action to assure the elimination of those Japanese acts, policies and practices described in paragraph (2) of section 1 of the resolution. Within 60 days after this concurrent resolution is agreed to, the President must report his determination, along with appropriate reasons, to the Committee on Ways and Means of the House of Representatives and the Senate Committee on Finance. A summary of this report also must be published in the Federal Register.

If the President's determination is negative, the President is directed to take action to seek the elimination of those Japanese acts, policies and practices through the use of existing customs laws and other U.S. trade laws governing the importation of merchandise to restrict Japanese imports into the U.S. market. The action taken under this section should be sufficient to insure that access to the Japanese market is fair and equitable, as measured by increased sales of competitive products from the U.S. and elsewhere, and verified by affirmation from the U.S. business community. The

report to the Congress required by this section also shall include a description of the President's actions taken hereunder.

*Section 3*

The final section provides that any action taken by the President under section (2)(b) may not be modified or revoked unless the President determines that the objective of eliminating those discriminatory Japanese acts, policies and practices described in paragraph 2 of section 1 has been achieved. The President is directed to report such a determination to the Congress and publish it in the Federal Register.

## VOTE OF THE COMMITTEE IN REPORTING THE BILL

In compliance with clause 2(1)(2)(B) of rule XI of the Rules of the House of Representatives, the following statement is made relative to the vote of the Committee in reporting the bill H. Con. Res. 107 was ordered favorably reported by the Committee by nonrecorded vote.

## OVERSIGHT FINDINGS

With respect to clause (2)(1)(3)(D) of rule XI of the Rules of the House of Representatives, no oversight findings or recommendations have been submitted to the Committee by the Committee on Government Operations with respect to the subject matter contained in this bill.

## BUDGET AUTHORITY AND COSTS ESTIMATES

In compliance with clause 7(a) of rule XIII and clause 2(1)(3)(B) of rule XI of the Rules of the House of Representatives, the Committee states that H. Con. Res. 107 does not provide any new budget authority or any new increase in tax expenditures.

## INFLATIONARY IMPACT STATEMENT

With respect to clause 2(1)(4) of rule XI of the Rules of the House of Representatives, the Committee states that H. Con. Res. 107, which would have no direct effect on revenues, would not have an inflationary impact on prices and costs in the operation of the general economy.

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance of clause 3 of rule XIII of the House of Representatives, the Committee states that no changes in existing law will be made by House Concurrent Resolution 107.

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